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In the Supreme Court of the United States

OCTOBER TERM, 1946

FLOY K. WILLIAMS ET AL, APPELLANTS

vs.

RAILROAD COMMISSION OF TEXAS ET AL, APPELLEES

ON APPEAL TO THE SUPREME COURT OF THE UNITED STATES FROM THE JUDGMENT OF THE COURT OF CIVIL APPEALS FOR THE THIRD SUPREME JUDICIAL DISTRICT OF TEXAS

REPLY OF APPELLANTS FLOY K. WILLIAMS ET AL TO APPELLEES' OPPOSING STATEMENT AND MOTION TO DISMISS OR AFFIRM

INDEX

	Page
Summary of the Reply	1
I. This Court has not heretofore ruled adversely to appellants' contentions; and the question involved in the appeal is substantial	2
II. The decision of the Texas court, regardless of the effect thereon of local law, has the effect to sanction a taking of appellants' property without due process of law	7
Acknowledgment of service	16

AUTHORITIES

	Page
Atlantic Production Company vs. Railroad Commission of Texas et al, 85 S. W. (2d) 655	9
Corzelius vs. Harrell, 143 Tex. 509, 186 S. W. (2d) 961	8, 9
Gulf Land Company et al vs. Atlantic Refining Company et al, 134 Tex. 59, 131 S. W. (2d) 73, 80	8, 9
Marrs vs. Railroad Commission, 142 Tex. 293, 177 S. W. (2d) 941, 948	8, 9
Railroad Commission of Texas et al vs. Gulf Production Company, 134 Tex. 122, 132 S. W. (2d) 254, 255	9
Railroad Commission vs. Humble Oil & Refining Company et al, 193 S. W. (2d) 831	3, 4, 5, 8, 15
Railroad Commission et al vs. Humble Oil & Refining Company, 311 U. S. 578	2
Railroad Commission of Texas et al vs Rowan & Nichols Oil Company, 311 U. S. 570	2
Railroad Commission of Texas et al vs. Rowan & Nichols Oil Company, 310 U. S. 573, 311 U. S. 614	1, 2
Texas Company vs. Daugherty, 107 Tex. 226, 176 S. W. 717	8

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Appellants Floy K. Williams, D. F. Williams, L. A. Bryan, Jr., Jack Kay, Paul D. Smith, R. L. Peveto, Florence Cowles Hamlett and A. L. Atkins, replying to the opposing statement and motion to dismiss or affirm filed by appellees Railroad Commission of Texas et al, show:

Summary of the Reply

Contrary to Appellees' contentions,

(1) This Court has not, in *Railroad Commission of Texas et al vs. Rowan & Nichols Oil Company*, 310

U. S. 573, 311 U. S. 614; *Railroad Commission of Texas et al vs. Rowan & Nichols Oil Company*, 311 U. S. 570; and *Railroad Commission et al vs. Humble Oil & Refining Company*, 311 U. S. 578, ruled adversely to appellants' contentions; and the question involved in the appeal is substantial.

(2) The decision of the Texas court, regardless of the effect thereon of local law, has the effect to sanction a taking of appellants' property without due process of law.

I.

This Court has not heretofore ruled adversely to appellants' contentions; and the question involved in the appeal is substantial.

Railroad Commission of Texas et al vs. Rowan & Nichols Oil Company, 310 U. S. 573, 311 U. S. 614-615; *Railroad Commission of Texas et al vs. Rowan & Nichols Oil Company*, 311 U. S. 570; and *Railroad Commission of Texas et al vs. Humble Oil & Refining Company*, 311 U. S. 578, ruled upon the validity of certain orders of the Railroad Commission of Texas applicable to the East Texas oil field. It was contended in those cases by Rowan & Nichols Oil Company and Humble Oil & Refining Company that certain allocation formulas or proration orders enforced to control distribution of the daily field allowable among the wells in the East Texas field were void, because, due to the allowable to marginal wells and failure of the Commission to give proper weight to the measurement of oil in place, to the better location of leases on the structure, to the ca-

pacity of wells to produce, and to the density of drilling on the various leases, enforcement of the orders resulted in unnecessary drainage of oil from the lands of the complaining parties. The facts with respect to the physical condition in the East Texas field, as developed in those cases, are vastly different from the facts with respect to the physical conditions in the Hawkins field. In those cases the Court declined to hold, "on the basis of conflicting expert testimony" (310 U. S. 581-582), that the action of the administrative tribunal was offensive to the Fourteenth Amendment, or to supplant "the feel of the expert" with "an independent view of judges on the conflicting testimony and prophesies and impressions of expert witnesses," or "to substitute the Court's wisdom for that of the legislative body" (311 U. S. 576-577).

In this case a different situation is presented. It is beyond controversy that the challenged proration formula results in uncompensated, **excess** drainage; it was shown by the testimony, and is admitted in the opposing statement and motion to dismiss or affirm (p. 15), and is recognized in the opinion of the Court of Civil Appeals (193 S. W. (2d) 831), that other proration formulas could be adopted which would reduce the extent of the drainage without resulting in waste of oil or gas. This case is, therefore, one in which there can be no conflict between the parties regarding the issue of **excess** drainage, or on the point that other proration formulas could be adopted which would substantially reduce the extent of the drainage without causing waste of oil or gas. In this case appellees attempt to sustain a proration

formula that results in excess drainage of oil from appellants' lands although the formula which causes such excess drainage is not necessary to prevent waste. Such a **conflict of testimony** as controlled the decisions in the above cases is not present in this case on the point which gives rise to the federal questions presented by this appeal.

In the instant case the Court of Civil Appeals stated that:

> * * * "While there was sharp conflict in the testimony upon several factual issues, there was no conflict regarding the issue of substantial uncompensated excess drainage. All the witnesses testified, and appellants (Railroad Commission and Ashcroft et al) admit in their brief, that there was such drainage, although not conceding the extent thereof as testified to by Humble's witnesses." (193 S. W. (2d) 829.)

Then, having stated that there are certain natural advantages which small tracts have over larger tracts in unrestricted production; that it is by no means certain, but hardly within the range of reasonable probability, that Humble would drill sufficient offset wells to prevent the townsite owners from producing as much as they produce under the order in suit; that certainly Humble would not drill to the same density as the townsite tracts, but "whether this would be necessary to prevent all drainage does not appear"; that just what effect unrestricted production would have on the field was not shown and probably could not be shown; that the larger tract

owners would share the larger in the benefits of conservation; and that "the evidence does not afford the means of evaluating these factors and probably means for such evaluation could not be obtained," the Court of Civil Appeals proceeded to discuss the saving in drilling and production costs resulting to Humble from the proration (193 S. W. (2d) 832-833), and then undertook to justify the challenged formula with the statement that:

> "Waiving other issues aside, however, and considering only the compensatory effect of reduced drilling costs, and this independently of reduced operating costs, we think the order was well within the discretionary powers of the Commission in making it." (193 S. W. (2d) 834.)

Elsewhere in the opinion (193 S. W. (2d) 831), the Court of Civil Appeals said that the evidence showed that the formula could be changed to increase the weight given to acreage with a reduction of the "per well" factor (which would obviously reduce the existing drainage) without causing waste.

In the opposing statement and motion to dismiss or affirm, appellees say: "It is conceded * * * that net uncompensated drainage is taking place to the townsite in substantial amounts," and that "It is true that by changing the proration order the Railroad Commission might **reduce** drainage" (p. 15, R. 2412). It is thus shown that both the Court of Civil Appeals and appellees recognize the fact of drainage and that the formula could be changed to reduce the extent of the drainage without causing

waste. (In connection with the above quoted statements, appellees attempt to justify the drainage by saying that there was testimony that the drainage was less than it would be in the absence of regulation, and to justify the failure to change the formula by saying that to change it would alter the relative rights of the parties as they would exist in the absence of restriction on production and deprive the townsite operators of the right to capture migratory oil. These statements will be discussed later in this reply.)

A fair interpretation of the opinion of the Court of Civil Appeals, aside from discussion of procedural errors, is that the Court of Civil Appeals recognized that the undisputed evidence showed that the challenged formula resulted in substantial, uncompensated, excess drainage from the larger tracts to the densely drilled townsite, and that another formula could be adopted which would reduce the extent of the drainage without causing waste; but, notwithstanding these facts, sustained the proration order on the basis that the saving to Humble in drilling and production costs resulting from proration compensated it for the drainage caused by the challenged formula. **This basis of decision did not take into account the rights of these appellants as owners of royalty oil which they are entitled to receive free of drilling and production costs.**

As to Humble, the question is: Can the drainage of large quantities of oil, resulting from an unnecessarily oppressive proration formula, be justified on the basis that Humble's losses from drainage are offset by the saving to Humble in drilling and produc-

tion costs resulting from proration? As to these appellants, who are royalty owners, the question is: Can the drainage of oil from lands in which they own royalty, caused by such an order, be justified on the basis that proration results in a saving in drilling and operating costs to the owner of the working or leasehold interest in such lands?

The contention of these appellants is that the fact, if it be a fact, that proration results in a saving in drilling and production costs to the owner of the leasehold or working interest, does not justify a formula which is not essential to the prevention of waste and admittedly results in substantial, uncompensated, excess drainage of their royalty oil; that, where it is shown that the formula results in such drainage and that another formula could be adopted which would substantially reduce the extent of the drainage without resulting in waste, the taking of appellants' property is without due process of law.

The question is grounded on the Due Process Clause of the Fourteenth Amendment; it is substantial, and neither of the *Rowan & Nichols cases* nor the *Humble case*, cited by appellees, ruled upon the question.

II.

The decision of the Texas court, regardless of the effect thereon of local law, has the effect to sanction a taking of appellants' property without due process of law.

The Court of Civil Appeals stated that "there was no conflict regarding the issue of substantial uncom-

pensated excess drainage," and that it was shown that another proration formula could be adopted which would reduce the extent of the drainage without causing waste of oil or gas. (193 S. W. (2d) 829, 831.)

Under Texas law oil in place belongs to the owner of the soil, subject to the right of capture by owners of adjacent property. *(Texas Company vs. Daugherty*, 107 Tex. 226, 176 S. W. 717; *Corzelius vs. Harrell*, 143 Tex. 509, 186 S. W. (2d) 961.) As is stated in the opinion of the Court of Civil Appeals (193 S. W. (2d) 832), "any restriction upon the number of wells drilled or the amount of production therefrom is essentially an infringement upon the right of private property, and can only be upheld as a conservation measure." In applying and enforcing the conservation laws of Texas, and particularly in adopting proration orders and allocation formulas, the law requires that the Commission take into consideration and protect the correlative rights of the persons and properties affected by such orders. *(Gulf Land Company et al vs. Atlantic Refining Company et al*, 134 Tex. 59, 131 S. W. (2d) 73, 80; *Marrs vs. Railroad Commission*, 142 Tex. 293, 177 S. W. (2d) 941, 948; *Corzelius vs. Harrell*, 143 Tex. 509, 186 S. W. (2d) 961, 968.)

In *Corzelius vs. Harrell*, the court said:

> " 'To adjust correlative rights' the Commission is authorized by this law to consider many items that relate to the production of gas, and it further provides that the Commission shall consider 'all other factors

> which are pertinent.' * * * The criterion fixed by the Legislature relating to the adjustment of correlative rights is as definite as that fixed by law to authorize the Commission 'to prevent confiscation of property' under Rule 37."

The Texas rule is that:

> * * * "every owner or lessee is entitled to a fair chance to recover the oil or gas in or under his land, or their equivalents in kind, and that any denial of such fair chance would be confiscation." *(Railroad Commission of Texas et al vs. Gulf Production Company,* 134 Tex. 122, 132 S. W. (2d) 254, 255; *Gulf Land Company et al vs. Atlantic Refining Company et al,* 134 Tex. 59, 131 S. W. (2d) 73, 80; *Marrs et al vs. Railroad Commission et al,* 142 Tex. 293, 177 S. W. (2d) 941, 948.)

In *Atlantic Production Company vs. Railroad Commission of Texas et al,* 85 S. W. (2d) 655, 657, the Court said:

> "Appellee is entitled, and entitled only, to be accorded an equal opportunity with surrounding lessees to recover his fair share of the recoverable oil; or, stated differently, to recover the approximate amount of oil lying in place under his lease."

The Court of Civil Appeals did not ground its decision in this case upon either a finding or holding that the proration formula here involved accorded

either the Humble or these appellants an equal opportunity with surrounding lessees to recover their fair share of the recoverable oil or to recover the approximate amount of oil lying in place under their leases as is their right under Texas law. On the contrary, it is recognized in the opinion of the Court of Civil Appeals that the owner and operator of wells drilled on lands in which appellants own royalty rights are not allowed an equal opportunity with other lease operators to recover the approximate amount of oil lying in place under such lands. The effect of the challenged formula is to deny that right to the owner and operator of wells on lands in which appellants own royalty rights, and so to take from appellants their royalty oil. The undisputed testimony from one of appellees' witnesses was that up to February 1, 1945, the drainage to the townsite had amounted to 2,000,000 barrels of oil (R., 1404).

The challenged proration formula, therefore, does not accord to appellants their property rights under Texas law. The Court of Civil Appeals attempted to meet this issue in so far as the leaseholder (Humble) is concerned by saying that through savings in drilling and production costs resulting from proration it is compensated for its drainage losses caused by the formula. That view recognizes the losses to the lease owner and its right to some character of compensation for its losses. But, what about the royalty owner? The lease owner's rights do not stand on any higher footing than the royalty owner's rights. The Court of Civil Appeals does not attempt to point out any compensation to these appellants for their losses through

drainage, unless it be said that proration results in a benefit to them. But proration results in a benefit to those who are draining appellants' lands and would do so even if they were denied by a proper formula the drainage benefit which they get as a result of the existing formula. Where the formula concededly results in drainage from appellants' lands and other formulas could be adopted which would reduce the drainage and accomplish the purpose of preventing waste, a denial to appellants of their property rights under Texas law is shown, and the taking is without due process of law. This taking is sanctioned by the opinion and judgment of the Court of Civil Appeals, and it is not founded upon Texas law but is contrary to the Texas law and the Due Process Clause of the Fourteenth Amendment.

In the opposing statement and motion to dismiss or affirm, appellees attempt to meet this situation on three bases:

(1) That appellants are petitioning the Court to substitute its discretion for the discretion of the Commission (p. 10, R. 2407);

(2) That there was no definite evidence as to any one of the royalty owners whether said royalty owner would during the life of the field, considering his total interest in the various leases, be permitted to recover more or less than the recoverable reserves originally in place (p. 11, R. 2408); and

(3) That appellants ignore existence of the rule of capture as a property right and, in effect, contend that in enforcing restricted drilling and production, the Commission must "change the Texas law of prop-

erty in oil and gas so as to restrict each operator to the oil in place beneath his land" (pp. 16-17, R. 2413-2414).

Appellants do not petition the Court to substitute its discretion for the discretion of the Commission. They asserted that the proration formula with the resulting drainage is not necessary to prevent waste; and in support thereof offered proof that another formula could be adopted which would substantially reduce the drainage without resulting in waste. Appellants' suit was not an attempt to have the Courts do that which the Commission should have done, but a suit to enjoin the enforcement of the existing order, leaving the Commission free to adopt another formula which would reduce or eliminate the inequities and the confiscatory effect of the challenged formula.

The evidence (R., 952-953) was to the effect that all of the leases in which these appellants hold royalty interests were suffering drainage as a result of the challenged formula; and that the formula did not allow the wells on these leases to produce in the same proportion as wells in the townsite are allowed to produce. (R., 1461-1462.)

There is no attempt by appellants in this case to require that anything be done which would deprive the townsite operators of the benefits of the rule of capture or to force the Commission to change the law of property in oil or gas, as suggested by appellees in their opposing statement and motion to dismiss or affirm (pp. 15, 16-17, R. 2412-2414). The effect of the rule of capture is to give a well owner title to the oil which is brought to the surface through his well.

It applies to unrestricted production and also to production under proration or conservation laws. In the case of unrestricted production the parties are allowed to fend for themselves. They can exercise rights under the rule both offensively and defensively,—offensively, by drilling and producing wells for the purpose of draining oil from their neighbors' lands; defensively, by drilling and producing wells to prevent their neighbors from draining oil from their lands. Under proration or conservation laws, the right of property owners to drill and produce wells is restricted. The exercise of what otherwise would be their rights under the rule of capture is curtailed, but the oil which is brought to the surface through a well still belongs to the well owner. The fact of regulation implies a necessity to recognize and protect correlative rights in the ownership of oil in place. The Texas courts have met this situation by establishing a Texas rule of property to the effect that each owner must be accorded an equal opportunity with surrounding lease owners to recover his fair share of the recoverable oil; or, stated differently, to recover approximately the amount of oil lying in place under his lease. Under this rule of property, it becomes the duty of the Commission in promulgating proration formulas to protect the correlative rights of property owners. As stated by the Court of Civil Appeals in the instant case, any restriction upon the amount of production is essentially an infringement upon the right of private property and it can only be upheld as a conservation measure. Where the testimony shows,

as in this case, that the formula adopted by the Commission results in unnecessary and uncompensated drainage and that other orders could be adopted which would prevent waste and reduce the amount of such drainage, it is demonstrated that the property rights of the lease and royalty owners, as existing under Texas law, have not been protected and, on the contrary, have been trespassed upon to the extent of an unlawful taking of property.

It was pointed out above that appellees state (p. 15, R. 2412) that there was testimony that the amount of drainage to the townsite was less than it would be in the absence of regulation. This was said in an attempt to defend the admitted drainage. The testimony of the witness to the effect that in his opinion Humble will recover a greater percentage of the oil than it would without restrictions, quoted in support of the statement, does not exactly support appellees' conclusion. In any event this witness on cross-examination testified (R., 1402-1043) that he did not know how many wells Humble would drill if there were no restrictions on drilling, and without that information it would be impossible to estimate how much oil Humble would produce from the field if there were no restrictions on drilling and production.

It is also pointed out above that in defense of the failure to adopt a formula that would reduce the extent of the drainage, appellees state in the opposing statement and motion to dismiss or affirm that "this would amount to altering the relative rights of the parties as they existed under unrestricted conditions and thereby depriving townsite operators of the right to capture migratory oil." It is sufficient

answer to this contention to point out that the Court of Civil Appeals said (193 S. W. (2d) 832): "Just what effect unrestricted production would have on the field was not shown and probably could not be shown."

Proration necessarily limits the extent to which the right to drill wells and capture oil may be exercised. The very fact that it does so limit the exercise of a right otherwise existing demands that the correlative rights of operators be protected and that one operator be not reduced to a state of helplessness while his neighbor takes his property under the protection of a proration order. A formula that results in drainage and that is unnecessary to prevent waste cannot be defended on the basis that the person who receives the benefit of the drainage would have right thereto under full play of the rule of capture in unrestricted production. Neither can it be said that such a formula cannot be corrected to reduce the unnecessary drainage because thereby the party benefited by the drainage would be denied a right which he would have under unrestricted production, for that would dispute the right to enforce proration of production and deny existence of a duty to protect correlative rights when and where proration is enforced.

Respectfully submitted,

DAN MOODY,
Austin, Texas,
Attorney for Appellants
Floy K. Williams et al.

Service of the foregoing reply to appellees' opposing statement and motion to dismiss or affirm, by delivery of copies thereof to the undersigned, is acknowledged this the 12th day of May, 1947.

Price Daniel, Attorney General of Texas

Fagan Dickson, First Assistant Attorney General of Texas

Attorneys for Appellees Railroad Commission of Texas, et al

James P. Hart,

Attorney for Appellees Ashcroft et al.